INDEX

	Page
THE LEGAL PRINCIPLE INVOLVED	2
THE CASE AT BAR	6
CONCLUSION	6

CITATIONS

CASES:

Capone v. *U.S.*, 51 F. 2d 609 (C.A. 7, 1931)	2
Friedberg v. *United States*, 348 U.S. 142, 75 S. Ct. 138 (1954)	3
Guzik v. *U.S.*, 54 F. 2d 618 (C.A. 7, 1931)	2
Holland v. *United States*, 348 U.S. 121, 75 S. Ct. 127 (1954)	3
Smith v. *United States*, 348 U.S. 147, 75 S. Ct. 194 (1954)	3
U.S. v. *Calderon*, 348 U.S. 160, 75 S. Ct. 186 (1954)	3

IN THE

Supreme Court of the United States

OCTOBER TERM, 1961

No. 562

HARRY AND AMANDA SCHROEDER, *Petitioners,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

---

PETITIONERS' REPLY TO OPPOSITION OF RESPONDENT

The total evasion of the thrust of this Petition for Certiorari by Respondent's Opposition compels this Reply. Completely ignoring the profound and urgent legal problem posed, Respondent's Opposition merely reiterates the government's "give the dog an ill name and hang him" technique. Respondent does not deny that this Court has never granted certiorari in a case of this type, even though civil net worth tax cases represent an out-size proportion of all litigation pending in the federal court system. Neither does Respondent deny that the Commissioner of

Internal Revenue, without specific sanction by this Court or by Congress, has applied to civil net worth cases procedures approved by this Court for criminal cases only.

THE LEGAL PRINCIPLE INVOLVED

The first two, and most important, of the QUESTIONS PRESENTED by Petitioner appeal to this Honorable Court for some ground rules on the legal playing field where economic life and death is more often than not involved, than anywhere else in the Federal judicial system.[1]

The net worth method is a phenomenon which clearly and concededly developed from the employment (out of desperation) of the tax laws to destroy the gangsterism of the late 1920's.[2] In all these cases (and the cases following their precedent):

1. Convictions for criminal tax evasion were involved;

2. the Commissioner had a burden of proof to prove generally evasion and intent beyond reasonable doubt, but

3. the Commissioner did *not* have to prove the additional tax liability to a mathematical certainty.

---

[1] The 1961 Annual Report of the Commissioner of Internal Revenue emphasizes that, "During the fiscal year 1961, $2.1 billion of additional tax, penalties, and interest were assessed as the result of direct enforcement activities". This report further informs that, "Both at the beginning of the fiscal year and at the end there were nearly $1.5 billion involved in cases wherein taxpayers sought to contest their liabilities for taxes and/or penalties". On June 30, 1961 some 11,133 civil tax cases were pending in the Tax Court of the United States alone. There are no statistics available to delineate the part the net worth method has played in giving rise to this litigation. Based on the reported cases alone, the net worth cases are legion.

[2] *Capone* v. *U.S.*, 7 Cir. 1931, 51 F. 2d 609. *Guzik* v. *U.S.*, 7 Cir. 1931, 54 F. 2d 618.

In 1954, this Honorable Court reviewed four cases in which criminal convictions for tax evasion rested on the net worth theory.[3]

Although the Court has since accepted jurisdiction of several other criminal net worth tax cases, its Opinions have been directed toward clarifying certain technical matters related to the landmark decision in *Holland*. Among the many important pronouncements in *Holland* we find:

> "The net worth method, it seems has evolved from the final volley to the first shot in the Government's battle for revenue, and its use in the ordinary income-bracket cases greatly increases the chances for error."
>
> • • • • •
>
> "While we cannot say that these pitfalls inherent in the net worth method foreclose its use, they do require the exercise of great care and restraint. The complexity of the problem is such that it cannot be met merely by the application of general rules".

Disregarding even the above rules and other guideposts of *Holland*, the Commissioner thereafter conceived that completely unlimited application of the criminal net worth method was sanctioned for civil tax cases; falsely reasoning that what is permitted for a criminal case, is doubly permissible in a civil case. Thus, although use of the method in civil cases is sanctioned neither by statute nor by this Court, and not even by the Commissioner's own regulations, the civil net worth case today, with its inevitable reliance on arbitrary estimates, is one of the heaviest burdens which taxpayers must bear.

---

[3] *Holland* v. *United States*, 348 U.S. 121, 75 S. Ct. 127 (1954), *Friedberg* v. *the United States*, 348 U.S. 142, 75 S. Ct. 138 (1954), *U.S.* v. *Calderon*, 348 U.S. 160, 75 S. Ct. 186 (1954) and *Smith* v. *United States*, 348 U.S. 147, 75 S. Ct. 194 (1954).

However, in every civil case conditions completely different from, and inconsistent with, conditions maintaining in criminal net worth cases (the only cases which have been subject to the scrutiny of this Court) apply:

1. Criminal intent, and the general fact of evasion, provable by approximation and without need for mathematical certainty, and subject to a burden of proof "beyond a reasonable doubt"[4] are not involved.

2. The Commissioner has no burden of proof at all, —instead the Commissioner's administrative determinations, made by the net worth method, are immediately *presumed* to be prima facie correct.[4]

3. The Commissioner, though required in civil cases to prove additional tax liability to a mathematical certainty, undertakes to do so simply by making a net worth determination (which at best can be an approximation) and asserting it to be prima facie correct.

The travesty of applying the criminal net worth rules to civil net worth cases thus is apparent both in theory and in fact. A pseudo-accounting method which under the best of circumstances is almost impossible to refute, imposes upon taxpayers a prima facie correct tax liability by administrative fiat.

All this has been done in the name and under color of the *Holland* doctrine which this Honorable Court, with obvious reluctance, sanctioned only in criminal cases.

---

[4] In other words—if in a criminal case an arbitrary, illogical net worth computation (as the one upheld below) does not meet the standards of "proof beyond a reasonable doubt", the Jury, the Court, or the Appellate Court will disregard it. In a civil case, such illogical computation is presumed to be correct and although undisprovable because of its very arbitrariness must be disproved by the taxpayer—a step beyond *Holland* never sanctioned or even contemplated by this Court.

The feat of legerdemain of transposing this doctrine to civil cases resembles nothing more than the old handkerchief trick where the conjuror substitutes the purple for the red artifact.

In practice, however, this use of the net worth method in civil cases (where the Commissioner—contrary to the criminal case—has the "presumption of correctness" to carry the burden of proof for him, instead of the burden of producing a net worth computation which will satisfy Judge, Jury and Appellate Court "beyond a reasonable doubt") has resulted in cases such as the one at bar. Here, as in many similar cases, the taxpayers are facing economic destruction in 1962 for alleged additional tax liability for years as far removed as 1944, although no deficiency or liability has been proven by acceptable or sanctioned standards of evidence.

In the chaos and confusion which has become an every day matter in the lower courts as a result of the Commissioner's thus making his own law in net worth cases, some of the courts have undertaken to strike at its worst abuses. However, the Circuit Courts have only rejected individual cases, upon narrow factual grounds which have, if anything, added more confusion.

For the foregoing reasons, it is prayed that this Court will take jurisdiction of this, its first civil net worth tax case.

THE CASE AT BAR

The brief for the Respondent in opposition has insidiously attempted to distract attention from the real problems involved by factual allegations which obscure rather than reveal.

Thus, Respondent admits that Petitioners had all of their basic records available even though they did not keep formal books of accounts. These records reflected what business of the taxpayers was handled over the telephone. That memoranda of the text of the telephone conversations were not maintained, (which certainly is normal procedure for a farmer (R. 144)) is then singled out to be the evidence of fraudulent intent and the justification for applying the extreme "version" of the net worth method upheld below.

CONCLUSION

It is submitted that the case at bar, as pointed out in the Petition for Certiorari, on its facts exemplifies the legal problem for which review is sought. It is a civil tax case. Some ten years after the events involved commenced, the Commissioner asserted deficiencies by administrative fiat, circumventing the bar of limitations by the application of his presumption of correctness, to establish consistent understatements as evidence of civil fraud.

From the first day of trial before the Tax Court, the United States admitted that the only real issue was the recomputation of certain inventories and that if the Commissioner had recomputed these inventories erroneously, the deficiencies could not exist. This recomputation of inventories was accomplished by a hypothetical formula never before used and without any validity despite the availability of an original record for virtually every transaction. The results obtained were absolutely inconsistent with contemporaneous documentary evidence.

On this basis, the case at bar comes to this Court as a last resort to prevent the economic destruction and im-

poverishment of the taxpayers and as a suitable occasion to lay down long needed rules for the application of the net worth method to civil tax cases.

Respectfully submitted,

DANIEL L. BRENNER
1005 Grand Avenue
Kansas City 6, Mo.

BERT B. RAND
729 15th Street, N. W.
Washington 5, D. C.

BRENNER, WIMMELL, EWING
& LOCKWOOD
1005 Grand Avenue
Kansas City 6, Mo.

TRAMMELL, RAND & NATHAN
729 15th Street, N. W.
Washington 5, D. C.
Of Counsel

DATED: JANUARY 25, 1962